

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

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CC:CORP:1 – PLR-146737-03

Date:

December 11, 2003

Distributing =

Controlled =

Company =

LLC =

Holdings =

Business A =

Business B =

Type 1 Entity =

Type 2 Entity =

a =

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b =

State W =

State Z =

Dear

This letter responds to your letter dated August 6, 2003, requesting rulings as to the federal income tax consequences of certain proposed transactions. Additional information was submitted in letters dated November 11, December 3, December 8, and December 9, 2003. The information submitted for consideration is summarized below.

Distributing, a closely held State W corporation, is an S corporation that uses the accrual method of accounting. Distributing is directly engaged in Business A. Distributing owns all the single class of stock outstanding of Holdings, a qualified subchapter S subsidiary that is disregarded for federal income tax purposes. Holdings owns a% (less than 50%) of the current single class of Controlled common stock, which is engaged in Business B. Company, a publicly held State Z holding company, also owns a% of Controlled stock and the remaining b% of Controlled common stock is owned by LLC, a limited liability company.

Distributing has submitted financial information indicating that Distributing and Controlled each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

A detailed opinion from a financial advisor indicates that the conversion of Controlled from a Type 1 Entity to a Type 2 Entity would permit Controlled to expand into other business areas. Additionally, a detailed opinion from a legal advisor indicates that under applicable federal regulations, such conversion is not possible without the separation of Distributing and Controlled.

To accomplish the separation of Distributing and Controlled, Distributing has proposed the following steps (the "Steps") in the proposed transactions:

- (i) Controlled will amend its By-Laws to authorize the issuance of Class A common stock (the "Controlled Class A Common Stock") and Class B common stock (the "Controlled Class B Common Stock"). The Controlled Class A Common Stock entitles shareholders to one vote per share and entitles the class to elect 20% of Controlled's directors. The Controlled Class B Common Stock entitles shareholders to one vote per share and

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entitles the class to elect 80% of Controlled's board of directors. The the vote of a simple majority of the board of directors will be required for all board actions and the By-Laws will not contain any provisions that restrict the authority of the board of directors to vote on any specific matters. Other than the difference in the right to elect directors, each class of Controlled stock will be identically entitled to dividends (except if a distribution is paid in common stock, each class may receive only that particular class of stock) and neither class will have any liquidation preference or limitation relative to each other. Immediately before Step (ii), Distributing will exchange its Controlled common stock for all of the Controlled Class B Common Stock and Company and LLC will exchange their Controlled Common stock for all of the Controlled Class A Common Stock (the "Recapitalization").

- (ii) Distributing will distribute to its shareholders on a pro rata basis all of the Controlled Class B Common Stock (the "Distribution").

The following representations have been made with respect to the Recapitalization:

- (a) The fair market value of the Controlled A Common Stock and Controlled B Common Stock held by Controlled shareholders immediately following the Recapitalization will approximately equal the fair market value of the Controlled common stock held by such shareholder immediately before the Recapitalization.
- (b) Controlled is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of section 368(a)(3)(A) of the Internal Revenue Code (the "Code").
- (c) The management of Controlled has no plan or intention to and will not, propose or support any plan or recapitalization or amendment to Controlled's organic documents or other action providing for (i) the conversion of shares of any class of Controlled stock into a different class of Controlled stock; (ii) any change in the absolute or relative voting rights of any class of Controlled stock from the rights existing at the time of the Distribution; (iii) any change in the manner of election or duties and responsibilities of the Controlled board of directors from those existing at the time of the Distribution; or (iv) any action having an effect similar to (i), (ii), or (iii).
- (d) The Recapitalization is a single, isolated transaction and is not part of a plan to

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periodically increase the proportionate interest of any shareholder in the assets or earnings and profits of Controlled.

The following representations have been made with respect to the Distribution:

- (e) Controlled and Distributing will each pay their own expenses, if any, incurred in connection with the transaction.
- (f) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (g) The five years of financial information submitted on behalf of the active businesses of Distributing and Controlled are representative of each corporation's present operations. With regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (h) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with their separate employees.
- (i) The distribution of the stock of Controlled is carried out for the corporate business purpose to permit Controlled to convert from a Type 1 Entity to a Type 2 Entity. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (j) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the transaction, except for historical gifts to Distributing's family members and private charitable foundations.
- (k) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction.
- (l) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of this transaction.

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- (n) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for short term receivables.
- (o) Payments made in connection with all continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (p) No parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

Based solely on the information submitted and the representations set forth above, we hold as follows:

- (1) The exchange by Distributing of its Controlled common stock for Controlled Class A Common Stock and Controlled Class B Common Stock will qualify as a reorganization under section 368(a)(1)(E). Controlled will be a "party to reorganization" within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing on the exchange of its Controlled common stock for Controlled Class A Common Stock and Controlled Class B Common Stock (section 354(a)).
- (3) The basis of the Controlled Class A Common Stock and Controlled Class B Common Stock received in the Recapitalization will equal the basis of the Controlled common stock surrendered in exchange therefor (section 358(a)(1)).
- (4) The holding period of the Controlled Class A Common Stock and Controlled Class B Common Stock received in the Recapitalization will include the period during which Distributing held the Controlled common stock surrendered in the exchange, provided that the surrendered stock is held as a capital asset on the date of the exchange (section 1223(1)).
- (5) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders on their receipt of Controlled Class B Common Stock (section 355(a)).
- (6) No gain or loss will be recognized by Distributing on the distribution of Controlled Class B Common Stock to Distributing shareholders (section 355(c)).
- (7) The aggregate basis in Distributing and Controlled stock held by each Distributing shareholder will equal the aggregate basis of such shareholder's

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Distributing stock immediately before the distribution, allocated in proportion to the fair market value of each in accordance with Treas. Reg. section 1.358-2(a) (section 358(a)(1), (b), and (c)).

- (8) The holding period of the Controlled Class B Common Stock received by each Distributing shareholder will include the holding period for the Distributing stock with respect to which the distribution is made, provided that the Distributing stock is held as a capital asset on the date of the distribution (section 1223(1)).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

No opinion is expressed about the tax treatment of the transaction under other provisions of the Code and Income Tax Regulations or about the tax treatment of any conditions existing at the time of, or effect resulting from, the transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the factual information, representations, and other data may be required as part of the audit process.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Mark S. Jennings
Mark S. Jennings
Chief, Branch 1
Office of Associate Chief Counsel
(Corporate)

cc: